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ABSTRACT

This report identifies improvements needed in administration of the guaranteed student loan program. Improvements needed are based on the fact that that lenders are not informed when student borrowers drop out of school. Alternatives for providing lenders with timely information on enrollment terminations are indicated. Additional administrative problems discussed induce ineffective collection efforts, improper handling of collections on defaulted student loans, and errors in lenders' billing. Conclusions and recommendations are suggested. Appendices include statistical data. (MJM)

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ED 077373

Improvements Needed In Administration Of The Guaranteed Student Loan Program B-164031(1)

Office of Education
Department of Health, Education, and Welfare

U.S. DEPARTMENT OF HEALTH, EDUCATION & WELFARE
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UNITED STATES
GENERAL ACCOUNTING OFFICE

HE 004 170

MARCH 30, 1973

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

MANPOWER AND WELFARE
DIVISION

B-164031(1)

The Honorable Caspar W. Weinberger
The Secretary of Health,
Education, and Welfare

Dear Mr. Secretary:

This is our report on improvements needed in administration of the Guaranteed Student Loan program by the Office of Education, Department of Health, Education, and Welfare.

Our principal observations are summarized in the digest of the report. The Department was aware of most of the problems discussed in the report and has informed us of a number of actions which have been or will be taken to improve the administration of the program.

Copies of this report are being sent to the House and Senate Committees on Appropriations and Government Operations; the appropriate legislative committees of the Congress; and the Director, Office of Management and Budget. Copies are also being sent to the Assistant Secretary for Education; the Assistant Secretary, Comptroller; and the Acting Commissioner of Education.

Sincerely yours,

Gregory J. Ahart

Gregory J. Ahart
Director

Contents

		Page
DIGEST		1
CHAPTER		
1	INTRODUCTION	5
	Program operation	6
	Loan activity	9
2	IMPROVEMENTS NEEDED IN ADMINISTRATION OF THE GUARANTEED STUDENT LOAN PROGRAM	11
	Major problem contributing to loan defaults--lenders not informed when student borrowers drop out of school	12
	Alternatives for providing lenders with timely information on enrollment terminations	18
	Conclusions	20
	Recommendations to the Secretary of HEW	20
3	OTHER ADMINISTRATIVE PROBLEMS	23
	Collection efforts not always effective	23
	Improper handling of collections on defaulted student loans	26
	Errors in lenders' billings	27
	Conclusions	29
	Recommendations to the Secretary of HEW	29
4	SCOPE OF REVIEW	32
APPENDIX		
I	Guaranteed Student Loan program volume by type of program fiscal years 1966-1972	33
II	Increases in loan volume and claims paid under the Guaranteed Student Loan program from inception through June 30, 1972	34

ABBREVIATIONS

GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
OE	Office of Education
VA	Veterans Administration

GENERAL ACCOUNTING OFFICE
REPORT TO THE SECRETARY
OF HEALTH, EDUCATION, AND WELFARE

IMPROVEMENTS NEEDED IN ADMINISTRATION OF THE GUARANTEED STUDENT LOAN PROGRAM

Office of Education
Department of Health,
Education, and Welfare B-164031(1)

D I G E S T

WHY THE REVIEW WAS MADE

Because of the rapid growth of the Guaranteed Student Loan program and the potential liability of the Government, the General Accounting Office (GAO) reviewed lender and State guaranty agency efforts to collect defaulted student loans insured under the State program component.

GAO also examined the administrative controls exercised by the Office of Education (OE), Department of Health, Education, and Welfare (HEW), over the payment of interest and special allowances under the State program.

As of June 30, 1972, 26 States, the District of Columbia, and the Virgin Islands were participating in the State program. GAO reviewed 22 lending institutions in Connecticut, Illinois, New Jersey, and New York and the State guaranty agency in each of these States and Pennsylvania.

Background

The Guaranteed Student Loan program enables students attending institutions of higher education and vocational schools to finance part of their education by obtaining long-term insured loans from banks, credit unions, and savings and loan associations.

The program, administered by OE, consists of a State or private nonprofit agency student loan insurance program and a Federal student loan insurance program.

The Government pays interest subsidies and special allowances on eligible loans while students are in school and during a grace period afterwards. The special allowances are also paid while a loan is being repaid. The Government bears all losses for defaulted federally insured loans and a large portion of the losses for defaulted State or privately insured loans.

As of June 30, 1972, about 4.8 million loans totaling about $4.5 billion had been made under the program. The Government had paid interest subsidies and special allowances totaling about $496.5 million and claims totaling about $53 million.

FINDINGS AND CONCLUSIONS

Although a significant number of students received financial assistance under the Guaranteed Student Loan program permitting them to pursue their education and although most of these students have taken steps to repay their obligations, loan defaults have increased steadily since fiscal year 1969.

OE officials estimate that 4 percent

of all student loans in a repayment status are in default. Data is not available to show whether the default rate is reasonable for a program of this type. The amount of defaulted loans, however, may continue to increase over the next several years because more loans are maturing each year--loan activity increased substantially from 1966 to 1972--and because the number of guaranteed loans is expected to increase in the future. (See p. 11.)

Better communication systems needed

Almost half of the Government's cost for default claims resulted from Federal reinsurance of loans made under the State program. Many loan defaults occurred because

--student borrowers left school and did not notify their lenders and arrange for the repayment of loans and

--lenders, OE, and State guaranty agencies did not have adequate procedures for obtaining such information and taking timely action to collect the loans. (See p. 12.)

Although lenders had records to remind them of when students were expected to graduate, they generally did not have procedures for identifying student dropouts. Students were often out of school for a year or longer before lenders learned they had defaulted on loans. (See p. 12.)

Prolonged delays in initiating collection action against delinquent borrowers decreased the possibility that their loans would be recovered. Such delays also extended the time during which lenders billed the Government for interest subsidies and special allowances on loans, resulting in additional program costs. Under existing regulations the Government is not supposed to pay lenders interest subsidies and special allowances once loans are in default. (See p. 14.)

OE has been studying methods of furnishing lenders more timely information on changes in the borrowers' enrollment status. A new system which OE believes will accomplish this objective is being implemented and will be initiated for the Federal program in the near future. If the procedure is successful, OE will adapt it to the State program.

GAO notes that other procedures in use could be adapted to the Guaranteed Student Loan program. GAO believes that alternative methods should also be evaluated by HEW so that a more informed decision can be made on how to best provide lenders with timely information. (See p. 18.)

Because OE's system for obtaining and disseminating information on student borrowers affects most of the approximately 20,000 lenders participating in the program, GAO believes the lack of timely information on school dropouts is indicative of a problem that may be experienced by many lenders. (See p. 20.)

Other administrative problems

Contrary to OE regulations, some lenders did not take timely collection action after being notified of student borrowers who had dropped out of school. (See p. 23.)

State guaranty agencies generally did not take legal action as a last

resort against borrowers defaulting on their loans. The agencies also took little or no collection action against defaulted borrowers living in other States. (See p. 25.)

GAO noted administrative weaknesses in some lenders' procedures for billing OE for interest subsidies and special allowances. These weaknesses were corrected after they were brought to the lenders' attention. (See p. 27.)

Although OE checks the accuracy of the interest computations on lenders' billings, OE did not have an effective method for verifying the propriety of the amounts reported by the lenders as outstanding loans which were used for computing interest and special allowances. (See p. 16.)

RECOMMENDATIONS OR SUGGESTIONS

The Secretary of HEW should direct OE to:

--Evaluate alternative methods for providing lending institutions in the Guaranteed Student Loan program with more timely information on names of student borrowers who graduate or drop out of school and require participating institutions of higher education, vocational schools, and lenders to cooperate in implementing the most feasible method. (See p. 21.)

--Emphasize to lenders their responsibility to adjust billings for interest subsidies and special allowances so that the Government can recover amounts paid before the date that lenders learn that a student borrower has defaulted on his loan. (See p. 21.)

--Continue to improve its monitoring of the collection efforts and interest billing procedures of State guaranty agencies and lending institutions and strengthen its own procedures for verifying the propriety and accuracy of billings submitted by lenders to insure that they are adequate. (See p. 29.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

HEW was aware of most of the problems discussed in this report and advised GAO that actions had been or would be taken to improve administration of the Guaranteed Student Loan program. (See pp. 21 and 29.)

CHAPTER 1

INTRODUCTION

The Office of Education (OE) of the Department of Health, Education, and Welfare (HEW) administers various support and assistance programs in education. One such program, commonly known as the Guaranteed Student Loan program, provides long-term insured loans for students in institutions of higher education and vocational schools. This program, established pursuant to title IV, part B, of the Higher Education Act of 1965, as amended (20 U.S.C. 1071), has two components--a State or private nonprofit agency student loan insurance program and a Federal student loan insurance program.

The purposes of the Guaranteed Student Loan program are to:

--Encourage States and private nonprofit institutions and organizations to establish adequate loan insurance programs for students in institutions of higher education and vocational schools.

--Provide a Federal program of student loan insurance for students or lenders who do not have reasonable access to a State or private nonprofit program of student loan insurance.

--Pay, on behalf of qualified students, a part of the interest charged by lending institutions on loans which are insured under either the Federal program or an eligible loan insurance program established by a State or private nonprofit institution.

--Guarantee a part of loans insured under an eligible loan insurance program established by a State or private nonprofit institution.

This report deals with our review of the State program component of the Guaranteed Student Loan program and is primarily concerned with the collection of loans, the payment of lenders' claims for defaulted loans, and the payment of interest and special allowances on insured loans. The fieldwork was conducted at 22 lending institutions in Connecticut, Illinois, New Jersey, and New York and at the State guaranty

agency in each of these States and Pennsylvania from October 1970 to July 1971. Our work at OE headquarters extended through November 1972.

We issued a report[1] to the Congress in December 1971 on the results of our review of the collection activities under the Federal student loan insurance program.

The HEW Audit Agency reviewed the administration of the Federal and State components of the Guaranteed Student Loan program and reported the results to the Commissioner of Education in April 1972. The audit agency's report generally dealt with the need for improvements in the payment of interest subsidies, the processing of claims, and the procedures for collecting defaulted loans.

PROGRAM OPERATION

Under the Guaranteed Student Loan program, students borrow money directly from a bank, a credit union, a savings and loan association, or any other participating lender and the loans are insured either by the Government or by a State or private nonprofit agency.

Students may obtain a loan application from a participating lender, a school, a State or private guaranty agency, or an HEW regional office. The student lists his educational expenses and financial resources on the application and forwards it to the school that he will be attending. The school certifies the loan application to show that the student is eligible for the program and submits the application to the appropriate lending institution. If the lender agrees to make a loan, it determines the amount and submits the application to the appropriate HEW regional office or State or private guaranty agency so that the loan can be insured.

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[1]"Office of Education Should Improve Procedures to Recover Defaulted Loans Under the Guaranteed Student Loan Program" (B-117604(7), Dec. 30, 1971).

Before enactment of Public Law 92-318 (Education Amendments of 1972) on June 23, 1972, the total of the loans made to a student for any single academic year or its equivalent could not exceed $1,500 and the aggregate unpaid principal amount of all such insured loans made to any student could not at any time exceed $7,500. A student was eligible to have the Government pay a portion of the interest on his loan if the combined adjusted gross income of the student (and his parents and spouse, if applicable) as reported for Federal tax purposes for the preceding year (minus 10 percent and amounts allowable for personal exemptions) was less than $15,000.

The new legislation increases the maximum annual loan amount to $2,500 and provides that the aggregate unpaid principal amount can be as high as $10,000 for graduate or professional students. It also stipulates that, before a student can qualify for the interest subsidy, the school must provide the lender with a statement recommending the amount of the loan that the student needs to meet the cost of his education after considering expected family contributions and other resources or aid available to him. The needs test requirement for a subsidized loan applies to all students, regardless of whether their adjusted family incomes are more or less than $15,000.

On August 19, 1972, the President signed Senate Joint Resolution 260 which delays implementation of the needs test requirement until March 1, 1973. This legislation enabled lenders to provide loans on the same basis as they did in the previous year, so that students could borrow in time to attend school in the fall of 1972.

In 1965, when the Guaranteed Student Loan program was established, the maximum rate of interest that lenders could charge on student loans was 6 percent a year on the unpaid principal balance of the loan. Public Law 90-460, approved August 3, 1968, increased the maximum rate of interest to 7 percent a year.

Public Law 90-460 also authorized OE to enter into agreements with State and private guaranty agencies to provide for Federal reinsurance of loans made under the then-existing State program. The law provided for the agencies to be reimbursed for 80 percent of the principal amount of

their losses resulting from a student's default on a loan or from the nonpayment of a loan due to the death or disability of a student borrower. Public Law 90-575, approved October 16, 1968, increased such reimbursement for losses attributable to death or disability to 100 percent.

As of June 30, 1972, 24 States, Puerto Rico, and the trust territories were participating under the Federal program component of the Guaranteed Student Loan program and 26 States, the District of Columbia, and the Virgin Islands were participating in the State program under the Federal reinsurance provision of the legislation.

The Government pays all the interest on eligible student loans during the period the students are in school; during the grace period (generally 9 to 12 months after they leave school); and during periods when repayment is deferred for students serving in the Armed Forces, the Peace Corps, or the Volunteers in Service to America. After the grace period a student is required to repay the loan plus interest over a maximum period of 10 years, exclusive of any deferment period. On eligible loans made before December 15, 1968, the Government also pays 3 percent interest during the repayment period and the student pays the balance.

Public Law 91-95, approved October 22, 1969, authorizes the Government to pay a special allowance to lenders participating in the program whenever existing economic or money market conditions are impeding or threatening to impede the carrying out of the program purposes and are causing the return to lenders to be less than equitable. The special allowance is in addition to interest charges but cannot exceed 3 percent a year of the average quarterly unpaid principal of loans made under the program on or after August 1, 1969.

In their August 1969 reports[1] on amending the Higher Education Act of 1965, the Senate Committee on Labor and Public Welfare and the House Committee on Education and Labor discussed the need for lenders to be paid a Federal incentive allowance. The reports pointed out that in the preceding 8-month period the prime rate of interest charged

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[1]S. Rept. 368 and H. Rept. 455, 91st Cong.

by lending institutions to their most valued customers had increased five times to the point where it exceeded the 7-percent maximum rate authorized for guaranteed loans. The reports estimated that between 30 and 40 percent of the students seeking guaranteed loans for the first time in the fall of 1969 would be denied such aid because lenders throughout the Nation were cutting back on their participation in the program.

The reports indicated in part that the 7-percent interest rate for guaranteed loans should not be increased because:

--Students would have to continue paying the higher interest rate even though the prime rate was expected to subsequently drop.

--Many State laws had set usury rates at 7 percent for State guaranteed loans, and problems would occur with Federal preemption of such laws if a Federal interest rate were set higher than 7 percent.

The Secretary of HEW is authorized by law to establish the special allowance every 3 months and has the discretion either to set a nationwide rate or to set differing rates for different areas or sections of the Nation. Nationwide rates have been in effect since September 1969, fluctuating from 3/4 of 1 percent to 2-1/4 percent.

LOAN ACTIVITY

OE data showed that students obtained about 4.8 million loans under the Guaranteed Student Loan program from inception of the program in fiscal year 1966 to June 30, 1972. These loans totaled about $4.5 billion. Approximately 1.9 million loans totaling about $1.8 billion were insured under the Federal program, and approximately 2.9 million loans totaling about $2.7 billion were insured under the State program. Trends in the value of loans made under both the State and Federal components of the Guaranteed Student Loan program from fiscal year 1966 through fiscal year 1972 are shown in appendix I.

As of June 30, 1972, the number and amount of loans insured by the five State guaranty agencies included in our review were as follows.

State	Number	Amount
Connecticut	121,531	$ 143,965,137
Illinois	192,088	206,709,811
New Jersey	189,340	201,224,154
New York	784,853	774,431,487
Pennsylvania	374,118	386,498,181
Total	1,661,930	$1,712,828,770

OE data also showed that, from inception of the Guaranteed Student Loan program to June 30, 1972, the Government had paid claims of about $27.5 million under the Federal program and reinsurance claims of about $25.4 million under the State program. Data concerning increases in loan volume and claims paid during this same period is shown in appendix II. The Government received collections of about $822,000 on the claims under the Federal program and collections of about $1.2 million on the claims under the State program.

As of June 30, 1972, the Government had paid claims of about $20.1 million to the five State guaranty agencies in our review and had received collections of about $887,000 on these claims, as shown below.

State	Number of claims paid	Amount	Collections returned to OE
Connecticut	761	$ 975,594	$ 30,287
Illinois	2,750	2,815,915	143,879
New Jersey	1,159	1,256,237	55,098
New York	12,264	11,372,713	562,198
Pennsylvania	3,587	3,677,009	95,090
Total	20,521	$20,097,468	$886,552

OE data also showed that, from inception of the Guaranteed Student Loan program through June 30, 1972, the Government had paid interest subsidies of about $456.9 million and special allowances of about $39.6 million to all lenders participating in the program.

CHAPTER 2

IMPROVEMENTS NEEDED IN ADMINISTRATION OF THE GUARANTEED STUDENT LOAN PROGRAM

Although a significant number of students received financial assistance under the Guaranteed Student Loan program permitting them to pursue their education and although most of these students have taken steps to repay their obligations, loan defaults under the Guaranteed Student Loan program have increased steadily since fiscal year 1969. As of June 30, 1972, the Government had paid claims totaling about $53 million for loans on which students had defaulted. Of this amount, defaults totaling $4 million had occurred in fiscal year 1970, $17 million had occurred in fiscal year 1971, and $32 million had occurred in fiscal year 1972. OE estimates that it will pay lenders and State guaranty agencies approximately $43 million in fiscal year 1973 for defaulted loans.

The increase in defaults reflects the increasing number and amounts of student loans going into repayment status since 1969. Latest OE estimates indicate that about 4 percent of all student loans in a repayment status are in default. Because of the absence of any data on comparable loan programs, it is not clear as to whether the 4-percent default rate is reasonable for a program of this type. However, if loan defaults continue at about the same rate and if the amount of loans made each year--about $1.3 billion in fiscal year 1972--stays about the same, it seems likely that about $52 million in loans will be defaulted annually. Because the program is expected to continue to provide increasing numbers of students with a means of financing part of their postsecondary educational costs, the amount of defaulted loans may continue to increase, rather than stay the same, over the next several years.

Our review of collection efforts of lending institutions and State guaranty agencies participating under the State program component--almost half of the total claims paid by the Government were under this component--indicated a need for improved communication systems designed to provide

timely information on the enrollment status of student borrowers for OE, State guaranty agencies, and lenders to deal adequately with the problem of students defaulting on their loans. Many loan defaults occurred because student borrowers dropped out of school without notifying their lenders; the procedures established by lenders, OE, and State guaranty agencies for obtaining such information were not adequate. Students were often out of school for a year or longer before lenders learned that they had defaulted on their loans.

Prolonged delays in initiating collection action against delinquent borrowers decreased the possibility that their loans would be recovered. Such delays also extended the time during which lenders billed the Government for interest subsidies and special allowances on loans, resulting in additional program costs. Under existing regulations the Government is not supposed to pay lenders interest subsidies and special allowances once loans are in default.

MAJOR PROBLEM CONTRIBUTING TO LOAN DEFAULTS--LENDERS NOT INFORMED WHEN STUDENT BORROWERS DROP OUT OF SCHOOL

A student who borrows under the State student loan insurance program signs a promissory note which requires him to notify his lender during the grace period after he leaves school or when he ceases to carry the prescribed academic workload, to arrange for the repayment of his loan. The lending institutions that we visited told us that student borrowers often did not comply with this requirement.

The lenders kept records of expected graduation dates of student borrowers and periodically identified and contacted individuals who had not arranged to repay their loans even though their expected graduation dates had passed. Most of the lenders did not have procedures, however, for determining whether a student had dropped out of school before graduation.

Notification procedures not always effective

OE uses a procedure to assist lenders in identifying student borrowers who leave school. Twice a year--in October and May--OE furnishes each school participating in

the Guaranteed Student Loan program a list of the names of student borrowers who, according to OE records, should be enrolled at that school. OE obtains the students' names from information provided by lenders. OE encourages the schools to return the lists within 30 days, identifying any borrowers who did not actually enroll as students and any borrowers who graduated or dropped out of school.

The information provided by the schools is processed by OE through its computer system which prints a statement for each lender showing changes in the student status of borrowers and the dates of such changes. The statements are then sent to the lenders to apprise them of borrowers who are out of school and could be used by lenders to contact students to make arrangements for repaying their loans. Under this system it could take several months for a lender to learn of a student leaving school. We noted that the data OE provided to lenders often indicated that student borrowers had dropped out of school a year or more earlier than the date of the OE statements which reported the changes. Lenders told us that borrowers who are away from school for such a long period are sometimes difficult to locate.

Eight of the 22 lenders in our review told us that they made little or no use of the OE statements as a means of identifying borrowers who had left school. Some lenders stated that the data was often inaccurate or not complete. One lender was not aware that the statements were to be used for this purpose.

Four of the five State guaranty agencies included in our review had established some procedures to help them stay abreast of the enrollment status of student borrowers. These procedures were often not effective, however, in providing timely information on students who terminated their enrollment.

One State guaranty agency, after approving a student's application for loan insurance, sent the school a statement requesting the school to notify it of any subsequent changes in the student's enrollment status. To test the effectiveness of this agency's procedure, we selected 67 cases from lists which OE had provided to 2 lenders in our review notifying them of the names of students who had graduated or dropped out of school. Our analysis of the 67 cases showed

that the schools had informed the State guaranty agency of these changes in only 9 instances.

Two State guaranty agencies used essentially the same procedure as OE for confirming whether student borrowers were still enrolled in school. We reviewed 102 cases of default totaling about $219,000 at one of these agencies and determined that the borrowers had been out of school for an average of 6 months before the lenders learned of it through the agency's confirmation system. We noted that the delays in notifications were often the result of schools waiting until November or December to inform the State guaranty agency of students who had left school the previous spring.

The fourth State guaranty agency sent a questionnaire annually to all borrowers who had not obtained a guaranteed loan since the previous academic year and inquired as to whether they were still enrolled in school. The agency told us that the results of its questionnaire were useful in identifying borrowers who should be reminded to begin repaying their loans.

Risk of default increases with time

Lenders generally believed that the longer a student was out of school without contacting the lender and making arrangements to repay his debt the higher the risk he would default on his loan. It appears that part of the problem stems from student mobility--many leave the area after dropping out or graduating. One of the State guaranty agencies included in our review made a study of student borrowers who had defaulted on their loans and estimated that about 40 percent had left the State after graduating or dropping out of school. Another State guaranty agency could not locate about 10 percent of the borrowers who had defaulted on loans that it had insured.

A procedure that would promptly notify lenders of a change in a student borrower's status would seem to offer the best promise for reducing the risk of default. Prompt notification would also help overcome the problem of lenders improperly billing OE for interest and special allowances after the student borrowers default.

Program costs increased for interest subsidies and special allowances

Because lenders often were not informed of student borrowers leaving school, they continued to bill OE for interest subsidies and special allowances on loans which should have been considered in default. As a result, OE incurred additional program costs.

As of June 30, 1972, OE had paid interest subsidies of about $456.9 million and special allowances of about $39.6 million to lenders participating in the Guaranteed Student Loan program. Although it was not feasible for us to estimate how much of these payments may have been in error, we did note that some of the billings submitted by lenders in our review were improper. OE has not established adequate procedures for verifying the propriety and accuracy of lenders' billings.

OE regulations governing the Guaranteed Student Loan program provide that, if a borrower leaves school and neglects to arrange for the repayment of his loan, the loan is in default at the end of the allowable 9 to 12 month grace period, and, after an additional 120-day delinquency period without payment, the lender is entitled to file a claim for reimbursement of the unpaid debt.

Regulations limit interest period

Before Public Law 92-318, the Government's obligation to pay interest terminated at the end of the borrower's grace period, and the borrower then became responsible for paying the loan principal and interest. Under OE regulations lenders could not bill OE for interest benefits beyond the beginning of the repayment period, whether or not the student actually began repayment at that time. The Government's obligation to pay the special allowance terminated when the loan was defaulted.

The new legislation, which was approved on June 23, 1972, authorizes the payment of interest through the 120-day delinquency period for loans insured under the Federal program. This change is expected to be implemented on March 1, 1973.

OE's regulations require lenders to make appropriate adjustments in their current billings for interest subsidies and special allowances when they learn they have made errors in previous billings. Our review showed, however, that some lenders were confused about the need for such adjustments in instances when they had billed OE for interest benefits and special allowances on loans that were in a default status without the lenders' knowledge.

Interest subsidies and special allowances paid on defaulted loans

Lenders generally bill OE every 3 months for the interest subsidy and special allowances due on eligible student loans. OE provides the billing forms which require the lenders to show the average quarterly principal balance of all loans eligible for (1) a 7-percent interest subsidy, (2) a 6-percent subsidy, (3) a 3-percent subsidy, and (4) the special allowance. Lenders must also show the total amount of interest subsidy due at each interest rate. OE computes the amount of the special allowance by applying the rate that is in effect at that time.

OE checks the accuracy of the lenders' interest computations by multiplying the average quarterly principal balances by the applicable interest rates. OE has no reasonable assurance, however, that the average quarterly principal balances as reported by the lenders include only those loans that qualify for interest subsidy and special allowance benefits. Lenders are not required to provide OE with a list of the loans that support the billings.

Lenders told us that they continue to bill OE for interest subsidies and special allowance payments on eligible loans as long as the lenders believe that the students are enrolled in school or are within the prescribed grace period. We noted many instances where lenders did not learn that students had left school until several months after their loans were in a default status.

For example, of the approximately 1,500 default claims that one State guaranty agency had paid at the time of our fieldwork, 704 claims, totaling $751,000, represented loans that were defaulted because the borrowers had not contacted the lenders by the end of the grace period to make

arrangements to begin repayment. Of the 704 default claims, we analyzed 121 that had been paid during a 2-1/2 month period and found that 46 of the 121 borrowers (38 percent) had been out of school for approximately 1 to 3-1/2 years, or an average of 1-1/2 years, before the lenders learned that they were no longer students. We estimated that OE incurred additional program costs of approximately $4,350 by making interest payments on the 46 loans after the borrowers' grace period had ended.

The Government also incurred additional program costs because some lenders did not consider information provided by OE which indicated that student borrowers had dropped out of school. These lenders continued to bill OE for interest subsidies and special allowance payments on loans until they learned of the defaults through some other means.

For example, one lender had not taken action to collect 241 defaulted loans totaling $470,000 even though OE had furnished the lender information 9 months earlier which showed that the students had left school. We estimated that OE incurred additional program costs of approximately $16,400 by making interest payments on the 241 loans after the borrowers' grace period had ended. About $3,400 of the additional program costs had been incurred before OE notified the lender of the changes in student enrollment.

ALTERNATIVES FOR PROVIDING LENDERS WITH TIMELY INFORMATION ON ENROLLMENT TERMINATIONS

In talking to lenders about the problem of students graduating or dropping out of school and defaulting on their loans, we were told that lenders would be in a better position to make timely collection efforts if schools would promptly notify them when such changes in enrollment took place. The lenders were particularly interested in having schools furnish them the names of students who drop out of school, because they already had tickler files on the dates their borrowers were expected to graduate.

OE officials are also concerned with the problem that lenders have in obtaining timely information on student borrowers who drop out of school. OE officials told us that OE is implementing a system for furnishing lenders with more timely information on changes in the student enrollment status of their borrowers.

Under the proposed system, information furnished by lenders about student loan commitments will be processed by OE through its computer system and a two-sectional card will be printed for each student. The card will be addressed and sent to the financial aid officer of the college the student will be attending. The financial aid officer will be expected to tear off the first section of the card and place it in the student's financial aid records and give the second section of the card to the registrar to place in the student's registration file. When the student terminates his enrollment, the registrar will be expected to record the date and check the appropriate reason for the termination on his section of the card and mail the preaddressed card to the lender who made the loan.

OE officials stated that the proposed system would be tested in the near future under the Federal program component of the Guaranteed Student Loan program and that, if it is successful in providing timely information to lenders, it would be used for federally reinsured loans made under the State program.

As discussed on page 13, a State guaranty agency used a system somewhat similar to OE's proposed system and it was not very effective. Therefore, OE should consider

several alternatives, such as those discussed below, that could be used to improve communication systems.

The Veterans Administration (VA) has a system for determining periodically whether students receiving VA educational assistance benefits are still enrolled in school. When a person eligible for VA benefits initially enrolls in an institution of higher education, he is required to have the registrar or certifying official sign a card provided by VA confirming that the student has enrolled. The school then sends the enrollment certification card to the appropriate VA regional office so that the student may begin receiving monthly assistance payments.

Before the beginning of each subsequent enrollment period--generally an academic term, quarter, or semester--the VA regional office provides the school with a computer-generated enrollment certification card for each student who was enrolled at the school for the previous period and received VA benefits. The registrar or certifying official is required to indicate whether the student reenrolled and return the card to the VA regional office.

If a student drops out of school during an enrollment period, the registrar or certifying official is instructed to furnish the VA regional office a special form indicating the change in enrollment so that timely adjustments can be made in the student's VA benefits.

A coupon system is another alternative that could be used for informing lenders periodically of student borrowers who were still enrolled in school. Under such a system, the student borrower would be given a book of coupons when he obtains a guaranteed loan and told to send a coupon to the lender each academic term, quarter, or semester. The student would be responsible for having the school registrar certify on the coupon that the student was still enrolled. If the lender did not receive a coupon within a reasonable time after it was due, the lender would then contact the student or the school and inquire about whether the student had terminated his enrollment.

An alternative coupon system would involve having the student mail the coupons, after certification by the registrar, to the State guaranty agency rather than to the lender.

The State guaranty agency would then notify lenders of the names of any students who were overdue in sending in their coupons.

CONCLUSIONS

Because the problem of collecting on student loans is expected to become more serious, effective action by OE, lenders, and State guaranty agencies is needed. The default problem could be controlled better if lenders were provided more timely information on when students with guaranteed loans terminate their enrollment. Lenders could then contact the borrowers and remind them to repay their loans.

Although OE is implementing a new procedure for apprising lenders under the Federal program of the names of students who leave school, we believe that alternative methods should also be evaluated so that a more informed decision can be made on how to provide lenders under both the Federal and State program components of the Guaranteed Student Loan program with the type of information they need to initiate timely collection efforts.

Because OE's system for obtaining and disseminating information on student borrowers who graduate or who drop out of school affects most of the approximately 20,000 lenders that participate in the Guaranteed Student Loan program, we believe the problem experienced by the lenders included in our review in obtaining timely and accurate information on student enrollment changes is indicative of a problem that may be experienced by many of the other lenders.

OE should emphasize to lenders that when they learn that they have billed OE for interest subsidies and special allowances on loans that have been defaulted, an appropriate adjustment should be made in their next billings to enable OE to recover any benefits it paid while the loans were in a default status.

RECOMMENDATIONS TO THE SECRETARY OF HEW

We recommend that the Secretary of HEW direct OE to:

--Evaluate alternative methods for providing lending institutions in the Guaranteed Student Loan program with more timely information on the names of student borrowers who graduate or drop out of school and require participating institutions of higher education, vocational schools, and lenders to cooperate in implementing the most feasible method.

--Emphasize to lenders in the Guaranteed Student Loan program their responsibility to adjust billings for interest subsidies and special allowances so that the Government can recover amounts paid before the date that lenders learn that a student borrower has defaulted on his loan.

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We met with HEW and OE officials in January 1973 to discuss our findings, conclusions, and recommendations. They stated that meetings and a number of workshops had been held with lenders, schools, and State government agencies to discuss the problem of timely information and that the decision to test the proposed two-sectional card system under the Federal program, as discussed on page 18, resulted from these meetings and studies.

We were told that preliminary work was underway to develop Federal regulations which would require all schools participating in the Guaranteed Student Loan program to provide lenders with timely information on student borrowers who leave school. A proposed rule on the regulations is expected to be published by August 1973, and the regulations are to be issued by December 1973.

HEW said that it has established a system under which approximately 80 schools with automatic data processing capabilities exchange reels of magnetic tapes or decks of punchcards with HEW twice a year for use in confirming the enrollment status of student borrowers. HEW pointed out that it receives information on student enrollment changes a little more timely under this system than it does under its system of sending lists of student names twice a year to schools. (See p. 12.)

HEW stated that it also planned to improve its method of obtaining information on loans made to student borrowers by lenders participating in the Federal program. HEW intends to begin using student applications for federally insured loans as the source of information for placing student names on the semiannual lists that it sends to schools, as opposed to its present method of waiting until lenders provide data showing that the loans were made. HEW pointed out that this change, which affects the Federal program but not the State program, will make it possible for schools to confirm the status of some student borrowers more quickly than could have been done in the past.

HEW said that it would continue to study and evaluate methods and procedures to provide more timely information to lenders.

We recognize that the actions taken or planned by HEW are steps in the right direction toward improving communication systems. However, we believe that, because the major effort appears to be directed toward the Federal program, HEW should consider testing alternative methods and procedures that could be applied to the State program.

HEW pointed out that its audit agency had recently examined the billing practices of more than 100 lenders and had found that the practice of billing the Government for interest on student loans beyond the borrower's grace period was the most common error made by the lenders. HEW stated that it would send a bulletin to all lenders in the Guaranteed Student Loan program reminding them not to bill for interest beyond the end of a borrower's grace period. We noted that the bulletin which was subsequently mailed to lenders did not instruct them to make adjustments effecting Government recovery of interest subsidies and special allowances paid on loans that had been defaulted.

HEW also told us that many of the problems described in our report are either directly or indirectly related to staff shortages and that the HEW budget request for fiscal year 1974 provides for additional positions to help eliminate this problem.

CHAPTER 3

OTHER ADMINISTRATIVE PROBLEMS

COLLECTION EFFORTS NOT ALWAYS EFFECTIVE

Although lenders and State guaranty agencies were hampered considerably in their collection efforts when they did not receive timely notification of student borrowers leaving school, they generally initiated collection action when they did learn of such terminations. In a number of instances, however, such actions were not timely, aggressive, or sufficient.

Lender collection efforts

Under the Guaranteed Student Loan program, lenders are required by law to use due diligence in attempting to collect student loans. OE regulations state that lenders' efforts are to be as extensive and forceful as those generally made by lenders collecting personal loans. Lenders' claims for reimbursement of defaulted student loans must be supported by copies of collection correspondence and records.

The lenders we reviewed generally sent one or more collection letters to a delinquent borrower and attempted to telephone or visit him before filing a claim with the State guaranty agency for reimbursement of the unpaid principal. The extent of the collection efforts varied, depending on such factors as whether the borrower could be located and whether he responded.

The lender with the largest volume of guaranteed loans--about 15 percent of the dollar volume--in one of the five State programs reviewed seldom took timely collection action when notified of student borrowers who dropped out. The lender's failure to respond to notifications from OE and other sources may have contributed to the large number of default claims the lender had processed--about 40 percent of all default claims reimbursed under the State guaranty agency's reinsurance agreement with OE. The lender told us that it delayed collection because of reorganizations and staff turnover as well as complications in handling such a large volume of loans.

Another lender in that State told us that it normally did not use techniques customarily used for its regular loans to locate delinquent borrowers who had moved and left no forwarding address. The lender did not believe the interest income on guaranteed loans was adequate for it to pursue techniques which could involve contacting employers, credit bureaus, post offices, and departments of motor vehicles.

Three of the five lenders that we visited in one State did not initiate collection efforts against some delinquent borrowers even though they were provided lists from OE which indicated that the borrowers had been out of school for as long as 2-1/2 years. These lenders believed they were not responsible for using OE's data to identify borrowers who leave school earlier than expected. We discussed this matter with the State guaranty agency and were told that a bulletin would be sent to all participating lending institutions in that State advising them of their responsibility to use the OE lists as a means of identifying borrowers who are delinquent in repaying their loans.

Two of the six lenders that we visited in a third State sometimes took several months before attempting to arrange for repayment of loans by borrowers after being notified that the students had left school. We sampled 38 default claim cases processed by these 2 lenders and noted that in 20 cases the lenders had taken less than 2 months to begin collection efforts. In the remaining 18 cases, it took the 2 lenders from 2 to 17 months after notification to take action.

State guaranty agency collection efforts

Under OE's agreement to reinsure loans made under a State student loan insurance program, the State guaranty agency is required to establish and maintain such administrative and fiscal procedures as are necessary to insure that due diligence is exercised in the collection of loans. After a State guaranty agency reimburses a lender for a default claim and, in turn, is reimbursed by OE for 80 percent of its losses, the agency has full collection responsibility and is required to return to OE 80 percent of any amount it subsequently recovers from the borrower. OE estimated that it had received about $1.2 million in collections from State guaranty agencies as of June 30, 1972.

The State guaranty agencies in our review had established procedures for assisting lenders in collecting defaulted student loans before the payment of a claim. Under these preclaim procedures, lending institutions informed the agencies of borrowers who had defaulted on their loans and the agencies supplemented the collection efforts of the lenders during the 120-day delinquency period. These efforts generally consisted of a series of letters and/or phone calls to the borrower or his parents. If the joint efforts of the lender and the State guaranty agency did not encourage the borrower to begin repaying his loan, the agency paid the lender's claim at the end of the deliquency period and continued its efforts to collect the loan.

The preclaim efforts have been successful in encouraging delinquent borrowers to begin repaying their loans. For example, one of the State guaranty agencies reported that because of these efforts only about half of the approximately 8,800 delinquency cases it processed in a 12-month period ended up as actual default claims. Another State guaranty agency reported that use of the procedure had prevented approximately 1,100 potential default claims totaling $1.6 million during an 18-month period.

The agencies also took systematic collection action after reimbursing lenders for defaulted loans. These actions consisted of periodic letters and phone calls to the borrower, his parents or relatives, his past and present employers, credit bureaus, and schools he attended.

State guaranty agencies told us that delinquent borrowers who ignored collection letters or refused to repay their loans without adequate justification were advised by letter that litigation would be initiated against them if they did not begin repayment. The agencies had made arrangements with either the State attorney general's office or private law firms to carry out the litigation. However, three of the five agencies generally had not taken legal action against the borrowers who failed to respond to such warnings.

One State guaranty agency advised us that it was reluctant to pursue litigation because its share of any collections on a defaulted federally reinsured loan would be limited to 20 percent, as compared with its court costs and legal fees which could amount to as much as 33 percent of

the collections. Another State guaranty agency had referred some defaulted loan claims to the State attorney general's office but litigation had not been pursued because of a workload problem.

We noted that the State guaranty agencies took little or no collection action against delinquent borrowers who lived in other States. Agency officials told us that such individuals are often difficult to locate and that to pursue collection actions against them would be costly.

IMPROPER HANDLING OF COLLECTIONS ON DEFAULTED STUDENT LOANS

The legislation governing the Guaranteed Student Loan program provides that, under the component for Federal reinsurance of loans made under the State program, State guaranty agencies are to apply collections on defaulted loans first to the reduction of loan principal and then to the payment of accrued interest. Two of the State guaranty agencies in our review did not adhere to this requirement and instead applied collections first to the payment of accrued interest. This practice increased the time a loan principal balance remained unpaid and resulted in higher interest charges to the student borrower.

We also noted that two State guaranty agencies did not properly share collections on defaulted student loans with OE. The agencies provided OE with 80 percent of the collections that were applied toward the reduction of loan principal but they did not return 80 percent of the collections that were used to pay accrued interest. The program legislation stipulates that State guaranty agencies must return to OE 80 percent of all collections received from borrowers in payment of their defaulted loans.

We brought these matters to the attention of State guaranty agency officials, and they agreed to change their procedures to provide for the proper crediting of collections on defaulted student loans and the proper sharing of collections with OE.

ERRORS IN LENDERS' BILLINGS

We noted several errors in lenders' billings for interest subsidies and special allowances in addition to the problem discussed earlier concerning billings for defaulted loans. The examples below show some of these errors.

--A lender billed OE for interest subsidies on some loans made to students who did not qualify for such benefits because their family incomes were too high.

--Two lenders billed OE for the 3-percent partial interest subsidy on some loans that did not qualify because they were disbursed after December 15, 1968. This subsidy is authorized to be paid during the repayment period for loans disbursed before that date.

--A lender used the date that it was informed of student borrowers leaving school as the starting point for the 9-month grace period rather than the date the students actually terminated their enrollment. As a result, the lender billed OE for interest that the Government had no authority to pay.

--A lender billed OE for the special allowance on many loans that did not qualify for such benefits because they were disbursed before August 1, 1969.

--Two lenders billed OE for the special allowance on the basis of the original loan principal rather than the unpaid principal balance.

The above types of errors were not widespread at the lenders we visited and are intended to show administrative weaknesses in lenders' billing procedures rather than significant additional costs to the program. The lenders corrected their procedures after we brought these matters to their attention. We believe, however, that such types of errors could result in significant additional costs to the program to the extent that they are made by the thousands of other lenders participating in the Guaranteed Student Loan program.

During its review of the administration of the Guaranteed Student Loan program, the HEW Audit Agency noted that

a number of lending institutions were computing interest on student loans using a method referred to in the industry as the "banker's rule." The audit agency questioned the use of this method--a generally accepted practice in the banking industry--because it resulted in an actual interest rate which was somewhat in excess of the maximum rate authorized by law.

Under the banker's rule, interest accruing over a portion of a year is computed by (1) multiplying the unpaid principal balance by the per annum interest rate and the number of days in the billing period and (2) dividing the product by 360 days. Over a year's time, interest is billed for 365 days on the basis of a 360-day year. The use of 365 days as a divisor would produce exact interest which would be a lesser amount.

The example in the HEW Audit Agency report, shown below, illustrates the difference in the computation of interest using the banker's rule and the exact interest methods. The example is based on a lender having an average loan principal balance of $100,000 for a 92-day billing period.

Banker's rule	
$100,000X7%X92/360 =	$1,788.89
Exact interest	
$100,000X7%X92/365 =	1,764.38
Difference	$ 24.51

As a result of the HEW Audit Agency inquiry, HEW's Office of the General Counsel ruled that the use of the banker's rule was not authorized under the legislation governing the program.

In September 1971 OE advised all lenders participating in the Guaranteed Student Loan program to review their method for computing interest and to change it if they were using the banker's rule. OE pointed out that the banker's rule was not authorized and told the lenders to use either a 360-day year and an equal number of days for each billing period or a 365-day year and the actual number of days for each billing period.

We determined that before this notification 5 of the 22 lenders in our review had used the banker's rule to compute interest on student loans. We estimated that the five lenders, which were perhaps not representative of all lenders because they were among the larger ones in the program, had billed OE for additional interest of about $28,500 during a 1-year period because of this practice.

CONCLUSIONS

Not all lenders and State guaranty agencies consistently took timely and aggressive action to collect student loans once they learned that the borrowers were no longer in school. OE should emphasize to lenders their responsibility to initiate timely collection action when they are notified that a student borrower has graduated or dropped out of school. OE could help improve collections by encouraging State guaranty agencies to pursue legal action as a last resort when borrowers who appear to have the financial capability to repay their loans refuse to do so.

OE incurred additional program costs by paying interest subsidies and special allowances on some loans that were never eligible for such benefits and by paying interest benefits that had been computed by lenders using the banker's rule. OE needs to establish a system that will provide greater assurance that lenders' billings are proper.

RECOMMENDATIONS TO THE SECRETARY OF HEW

We recommend that the Secretary of HEW direct OE to (1) continue to improve its monitoring of the collection efforts and interest billing procedures of State guaranty agencies and lending institutions and (2) strengthen its own procedures for verifying the propriety and accuracy of billings submitted by lenders to insure that they are adequate.

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At the previously mentioned January 1973 meeting, HEW pointed out that it holds semiannual group meetings with State guaranty agencies and gives them advice and guidance in the use of due diligence by lenders and the agencies to collect defaulted student loans. HEW stated that it

continuously emphasizes the need for better collection efforts in its communications with State guaranty agencies and in its onsite reviews of their programs. HEW said that it planned to visit all State guaranty agencies by December 1973 and review their claims and collection policies, practices, procedures, and results. Each agency will be informed by letter of HEW's findings and recommendations and must submit a reply describing the actions taken to improve collection efforts where needed.

HEW pointed out that it requires all lenders in the Guaranteed Student Loan program to provide a report at the end of each fiscal year showing total outstanding loans, total loans in a repayment status, and total delinquent loans. HEW computes ratios from this information and furnishes the information to its regional offices for their consideration in identifying and contacting lenders who need to improve their collection efforts. HEW mentioned that in the summer of 1972 it began requiring State guaranty agencies to identify lenders with high loan default ratios and to take appropriate action to have these lenders strengthen their collection procedures.

HEW said that it had noted improvement in the efforts of State guaranty agencies to collect defaulted student loans. Collection goals for the first 6 months of fiscal year 1973 had been exceeded.

HEW stated that it also monitors the collection efforts of State guaranty agencies by analyzing quarterly reports that they are required to provide on their operations. These reports contain cumulative statistical data on such factors as loans guaranteed, loans in a repayment status, claims paid, recoveries on claims paid, and ratios. HEW plans to require that the reports be provided on a monthly basis so that it can more promptly follow up on data that appears to be out of line.

HEW stated that it has taken steps to improve lender understanding of the correct interest and special allowance billing procedures. During our review an in-house task force studied the causes of interest billing errors, and special instructions were sent to all lenders and State guaranty agencies describing the proper method for requesting interest. In August 1972, HEW provided all State guaranty agencies and

all lenders under the Federal program with a comprehensive operating manual that contains a chapter of in-depth instructions on the preparation of interest and special allowance billings. The State guaranty agencies have been instructed to include this information in their manuals for lenders participating under the State program. HEW said that it had also increased the level of technical assistance in the preparation of interest and special allowance billings through onsite reviews at State guaranty agencies and lending institutions.

CHAPTER 4

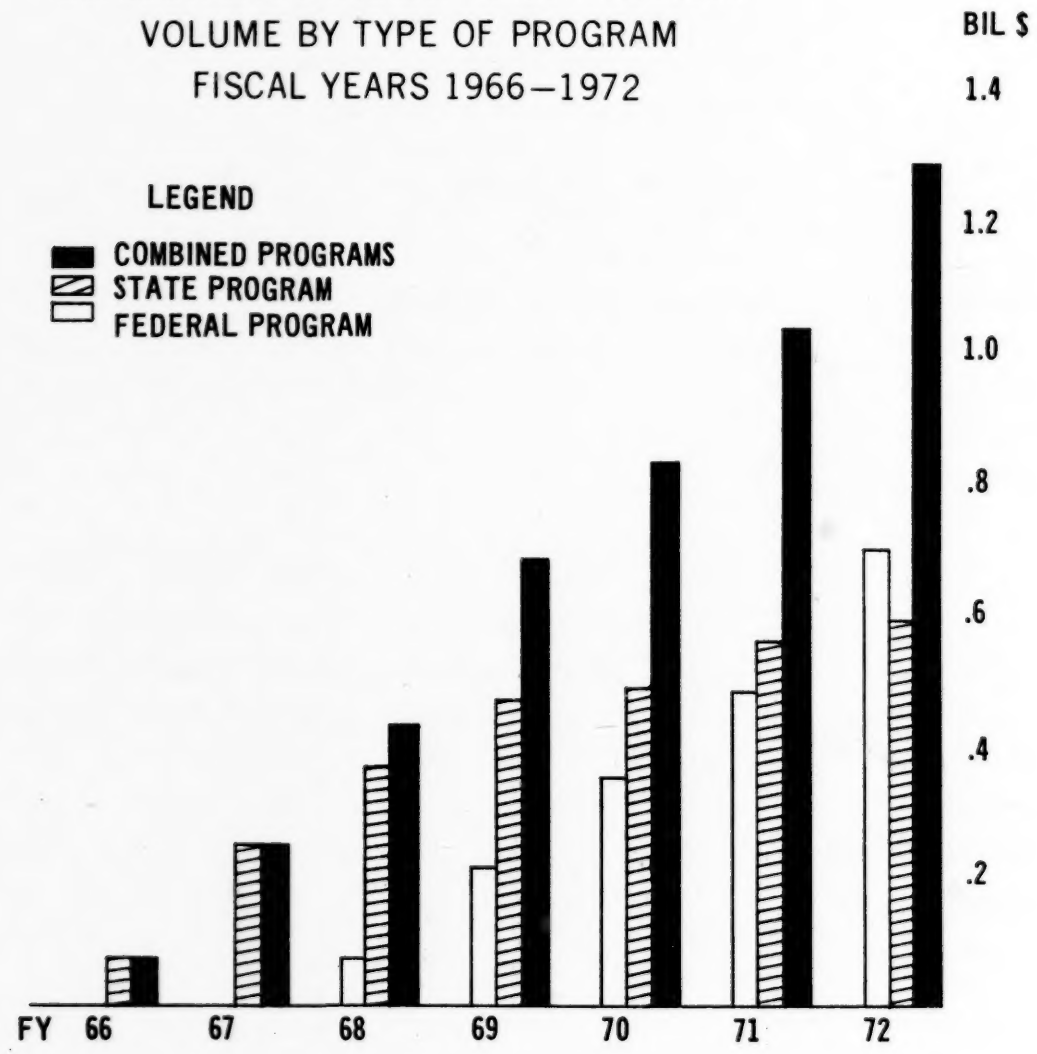
SCOPE OF REVIEW

Our review was made at OE headquarters in Washington, D.C.; at 22 lending institutions in Connecticut, Illinois, New Jersey, and New York; and at the State guaranty agency in each of these States and Pennsylvania. Seventeen of the lending institutions were commercial banks and five were savings and loan associations.

We examined applicable legislation; Federal and State guaranty agency regulations; and OE program policies, directives, guidelines, reports, and other documents relating to the Guaranteed Student Loan program. We also reviewed State guaranty agency and lender records and procedures for collecting defaulted student loans and lender records and procedures for determining interest subsidy and special allowance charges. We discussed the loan default problem with officials of all the State guaranty agencies and lenders that we visited.

We primarily examined the adequacy of the procedures of State guaranty agencies and lending institutions for collecting defaulted student loans. We also examined the adequacy of administrative controls over the payment of interest subsidies and special allowances.

GUARANTEED STUDENT LOAN PROGRAM
VOLUME BY TYPE OF PROGRAM
FISCAL YEARS 1966–1972



Prepared by the Office of Education

APPENDIX II

INCREASES IN LOAN VOLUME AND CLAIMS PAID
UNDER THE GUARANTEED STUDENT LOAN PROGRAM
FROM INCEPTION THROUGH JUNE 30, 1972 (note a)

	Fiscal years 1966 through 1969			Fiscal year 1970		
	State	Federal	Total	State	Federal	Total
	(thousands)			(thousands)		
Loan volume	$1,099,949	$284,162	$1,384,111	$425,973	$353,788	$ 779,761
Total claims paid	$ 248	$ 214	$ 462	$ 2,880	$ 2,036	$ 4,916
Defaults	$ 165	$ 51	$ 216	$ 2,274	$ 1,454	$ 3,728
Bankruptcy	3	40	43	106	239	345
Death and disability	80	123	203	500	343	843

	Fiscal year 1971			Fiscal year 1972		
	State	Federal	Total	State	Federal	Total
	(thousands)			(thousands)		
Loan volume	$531,112	$483,899	$1,015,011	$584,694	$708,164	$1,292,858
Total claims paid	$ 8,083	$ 8,520	$ 16,603	$ 13,291	$ 18,834	$ 32,125
Defaults	$ 7,085	$ 7,194	$ 14,279	$ 11,514	$ 16,997	$ 28,511
Bankruptcy	208	594	802	484	932	1,416
Death and disability	790	732	1,522	1,293	905	2,198

[a]Data provided by OE.

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